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**Leveling the Playing Field –
*OIFP Targets Workers' Compensation Premium Fraud***





Leveling the Playing Field

OIFP Targets Workers' Compensation Premium Fraud

by Melaine B. Campbell

Lurking beneath the smoldering surface of fraudulent workers' compensation claims lies a hotbed of corporate application and premium fraud. Although some businesses struggle to keep up with costs, others renege on their responsibility to protect injured workers. In New Jersey, the Office of the Insurance Fraud Prosecutor (OIFP), the insurance industry, the Compensation Rating and Inspection Bureau (CRIB), and producers are joining forces to combat workers' compensation application and premium fraud.

Throughout 2004, OIFP and insurance carriers have intensified their effort to detect, deter, and eradicate workers' compensation application fraud on all levels through investigation, prosecution, education, and research. OIFP has been identifying common fraud schemes and fraud indicators in workers' compensation applications and from premium fraud referrals. OIFP has participated in training for law enforcement and the industry to identify these fraud schemes and indicators, and has allocated resources to address the rising tide of application and premium fraud.

The Workers' Compensation System in New Jersey

Employers generally obtain workers' compensation insurance through the voluntary market, the residual or involuntary market otherwise known

as assigned risk, and through approved self-insurance.

CRIB defines the residual market process as employers who are ineligible for the voluntary market, purchasing workers' compensation insurance through CRIB. Employers in the residual market complete an application for designation of an insurance company. The application requires the employer to disclose the name and location of the employer's operations, taxpayer identification number, legal status, location of payroll records, ownership interests, prior insurance record, voluntary market rejections, description of operations, general eligibility information, classification of operations, including the number of employees and payroll, as well as other information designed to calculate the appropriate premium.

After review and approval by CRIB, a servicing carrier is designated to provide workers' compensation insurance to the employer. Under the residual market, an assigned carrier must accept an employer's application and issue a policy for at least one year. After one year, the carrier may request relief from CRIB and the employer may be assigned to another carrier.

According to CRIB, premium rates in the involuntary market are based on two basic factors: an annual premium level that will assess the total amount of money needed to pay the anti-

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pated incurred indemnity/medical obligations and the allowable items of overhead expenses, and apportionment of this total amount among all employers in a fair manner in relation to their contributions to the total claims cost. Cost apportionment is accomplished by a classification system that divides the industry in the State into approximately 600 business classifications. The realized hazards of each group are catalogued by compiling the payroll, premium, and incurred loss experience.

According to CRIB, this system provides a level playing field in terms of premium contribution, subject to statutorily required application of experience rating. Experience rating compares the loss history of a given employer with the expected losses of other employers of like size and kind assigned to the same classification. By comparing similar employers, CRIB produces a credit experience modification and extends premium savings to the employer enjoying fewer losses than average. Conversely, greater losses than average result in a debit modification and increased premium cost. The system provides each group of employers the opportunity to influence their own premium rate, thereby offering an economic incentive to control the frequency and severity of work-related injuries.

Industry for purposes of workers' compensation insurance is divided into three categories: manufacturing, construction/erection, and all other. These categories are further subdivided to form the basis for approximately 600 business classifications. Classification rates are based upon the losses that occur and the payrolls expended in a given business. Classification rates represent an average rate intended to encompass both the hazardous and non-hazardous work performed within the business at risk. Less hazardous operations within a given business reduce the overall rate for the class.

The premium is based primarily on a payroll estimate for the initial policy term. The final premium is determined by a final audit at the expiration of a policy. The final audit includes premium adjustment to the actual payroll expenditures made during the policy term through review of original payroll records, disbursement books, general ledgers, and payroll tax reports. The audit allows the carrier to review and amend classifications and rates that apply to the business and work covered by the policy. The premium is basically calculated by the following equation:

$$\text{Payroll}/100 \times \text{Classification(Rate)} \\ \times \text{Experience Modification Factor} \\ + \text{Expense Constant} + \text{Surcharges} \\ = \text{Premium}$$

Premium Fraud Scams

Some employers attempt to lower their premiums by lying on workers' compensation insurance applications and lying during or avoiding audits. Premium fraud, however, generally involves lies concerning payroll, classification (type of work done), and experience modification factor (claims history).

Although the employer may provide an estimated payroll to obtain workers' compensation insurance, a failure to disclose a significant amount of payroll is a fraud indicator and one of the most common types of premium fraud. Sometimes the scheme is more elaborate with employers paying employees "off the books" or misrepresenting the employees as "independent contractors." Some employers even hide payroll by creating bogus employee-leasing firms. Fraud may sometimes be detected when employees are on the payroll of "subcontractors" or "vendors" with common management or ownership. Other payroll fraud indicators may include a disproportionate amount of claims for the stated payroll, claimants who are not listed as employees in the audit, discrepancies in payroll reported to the insurer versus government agencies, and discrepancies in the size and type of operation versus payroll.

Employers may attempt to lower rates by lying about the business classification and locations of operation. Employers may represent that their employees work at lower-risk tasks: for example, a construction company may fraudulently place more payroll in clerical or sales jobs and less payroll in roofing classifications. Red flags should immediately go up when industrial and construction operations report only low-risk classifications for workers. Another fraud scheme involves lying about the number or location of operations by setting up storefront headquarters to hide high-risk or higher-rated job sites.



New Jersey Manufacturers Insurance Company Special Investigations Unit Director Loni Hand discusses workers' compensation premium fraud issues with John Kuller, Esq., at the Seventh Annual Insurance Fraud Summit. Hand is co-chair of OIFP's Workers' Compensation Working Group.



Employers may fraudulently reduce their premiums by lying about their loss and claims history. A business with a poor claims history might form a shell company that is essentially the same operation to handle on-going jobs.

Insurance carriers have become increasingly concerned about audit fraud. In some instances, an employer may repeatedly delay or impede a carrier's audit or it may provide false documents to avoid a premium increase. In other cases, scheming businesses might refuse to provide adequate records to a carrier. The State may, however, subpoena records or execute a search warrant if necessary to investigate misstatements of audit information or concealment of risk in order to commit fraud.

Workers' Compensation Fraud Statutes

The new Insurance Fraud Statute, N.J.S.A. 2C:21-4.5, 4.6, makes it a second degree crime to commit five or more acts of insurance fraud in an amount of \$1,000 or more, and a third degree crime for fewer than five acts or less than \$1,000. Prosecutors can charge other crimes, such as theft, under other criminal statutes in appropriate cases. Underwriting fraud is addressed in several workers' compensation statutes: N.J.S.A. 34:15-70 requires many employers to procure workers' compensation insurance for their employees; N.J.S.A. 34:15-57.4

renders providing a false statement or misrepresentation in connection with a workers' compensation application a fourth degree crime; and N.J.S.A. 34:15-79 renders failing to provide workers' compensation insurance a fourth degree crime. Of course, the New Jersey Insurance Fraud Prevention Act, N.J.S.A. 17:33A, provides civil penalties for workers' compensation application and premium fraud.

Closing the Loopholes

During 2004, a working group comprised of members of OIFP, the insurance industry, CRIB, and producer groups addressed issues relative to this type of fraud. The working group will continue to seek ways to uncover and deter schemes designed to conceal records, payroll, classification, and experience modification factor information.

Leveling the Playing Field

Premium fraud is destructive to the corporate sector and small businesses. Premium fraud not only drives up the cost of insurance, it also gives the fraudsters an unfair competitive advantage. This year's workers' compensation anti-fraud initiative provides the means to level the playing field.

Ron Brazda, Director-Underwriting, Compensation Rating and Inspection Bureau, contributed to this article.

(top left) Susan Aiani, Workers' Compensation Special Investigator, Chubb Insurance Group, instructs OIFP investigators on the detection of workers' compensation fraud. (top right) Neil Johnson, Vice President, Liberty Mutual Insurance Company and co-chair of OIFP's Workers' Compensation Working Group, reports to the Seventh Annual Insurance Fraud Summit on the Group's 2004 application fraud initiative.